483

SEFCU
A Federal Credit Union

Michael J. Castellana
President

Patroon Creek Corporate Center
700 Patroon Creek Blvd.
Albany, NY 12206-1067
518-464-5218
Fax: 518-451-2801
www.sefcu.com

April 24, 2006

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comments on Part 715 ANPR, Supervisory Committee Audits

Dear Ms. Rupp,

On behalf of State Employees Federal Credit Union, I would like to thank the National Credit Union Administration (NCUA) Board for inviting us to comment on the Advanced Notice of Proposed Rulemaking regarding Supervisory Committee Audits.

In response to the proposed rulemaking, the following comments are being submitted regarding: whether and how to modify the Supervisory Committee audit rules to obtain an "attestation on internal controls" in connection with the annual audits; to identify and impose assessment and attestation standards for such engagements; to impose minimum qualifications for Supervisory Committee members; and to identify and impose a standard for the independence required of state-licensed compensated auditors.

SEFCU is strongly committed to accurate and transparent financial statement and regulatory reporting. We believe the current requirements of NCUA Regulation Part 715 are reasonably designed and sufficiently support the continued health, safety and soundness of the credit union industry.

It is clear that NCUA issued this ANPR in response to comments made in 2003 by the U.S. General Accounting Office. The GAO stated: "NCUA might gain an evaluation of an institution's internal controls, comparable to other depository institution regulators, if credit unions were required, like banks and thrifts, to provide management evaluations of internal controls and their auditor's assessments of such evaluations."

The GAO's comments came at a time when corporate America was under intense scrutiny for perceived transgressions committed by the largest public companies. In response to those acts of extreme materialism and greed by the CEOs and other executives of said companies, Congress stepped in and passed the Sarbanes-Oxley Act in an effort to reign in and exert some control over the accounting and auditing practices of these large public companies. The intended outcome was to force these companies to increase the transparency of their operations for the benefit of stockholders.

484

Also in 2003, NCUA issued Letter to Federal Credit Unions 03-FCU-07 stating that Sarbanes-Oxley does not apply to credit unions, although credit unions were free, in fact encouraged, to apply any of the accounting and auditing standards as were reasonable in an effort to increase transparency for the benefit of members.

Now under this ANPR, NCUA is citing the Sarbanes-Oxley Act, as well as the Federal Deposit Insurance Corporation Improvements Act, in the discussion related to Internal Control Assessment and Attestation. It seems NCUA is using these statutes as a springboard for implementing new financial accountability rules for credit unions. However, the provisions contained in these statutes are designed for public corporations and stock owned financial institutions where investors have a financial stake. Modeling credit union Supervisory Committee Audit responsibilities after the requirements of Sarbanes-Oxley or the FDICIA simply doesn't make sense due to the corporate structure of credit unions. This could have the unintended effect of undermining credit union uniqueness and diversity.

SEFCU encourages NCUA to continue to issue guidance on standards for credit unions to follow in an effort to comply with the spirit, if not the letter, of the Sarbanes-Oxley Act. But, to do this in the regulatory arena is paramount to placing additional regulatory burdens on the credit union industry and fixing problems that simply do not exist. Rather than applying the "one bad apple" approach, NCUA should look to control any challenging or difficult situations on an individual basis, including sanctions where necessary, and not apply cookie-cutter, one-size-fits-all "fixes" on all credit unions.

It is SEFCU's firm belief that credit unions should be required by regulation to have an internal audit department or outsource the function of internal audit. Regulations requiring credit unions to employ some form of internal audit creates standards within the credit union industry that are measurable, quantifiable and subject to examination at regular intervals. What NCUA is attempting to address in this rulemaking could be (and already is, in many cases) handled within the credit union through an internal audit department. Some of the biggest problems happen in the smallest credit unions and employing an internal audit function serves to discover and resolve issues before they blossom into potential losses to the share insurance fund.

SEFCU's responses to the questions contained in the ANPR are as follows:

1. *Should Part 715 require, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting above a certain minimum asset size threshold?*

   SEFCU does not believe that attestation on internal controls should be required by regulation for credit unions at all, and absolutely does not support such a requirement based solely on asset size. SEFCU believes that Part 715 provides sufficient transparency and assurances for the accuracy of financial statement reporting, particularly since the regulation already includes increasing levels of audit requirements based on asset size. If this provision were to be finalized, SEFCU

would recommend NCUA base the requirement on a combination of asset size, applying only to those credit unions in excess of $1 billion, and the complexity of the credit union's operations. The trend in NCUA's thinking over the past several years has been toward a risk-based approach (risk-based examinations implemented a few years ago are a good example). Also, in the event NCUA and the credit union industry are successful in amending PCA to reflect risk-based net worth requirements, having risk-based auditing standards in place would promote consistency in the way credit unions are examined and rated.

2. *What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting, given the additional burden on management and its external auditor?*

   Again, SEFCU opposes any regulatory provision requiring attestation on internal controls. In lieu of this, as previously stated, SEFCU would support a provision requiring credit unions above $500 million in assets to have an internal audit department or outsource the function of internal audit.

3. *Should the minimum asset size threshold for requiring an "attestation on internal controls" over financial reporting be the same for natural person credit unions and corporate credit unions?*

   Corporate credit unions and natural person credit unions are both member-owned, not-for-profit financial institutions. Unless NCUA has a compelling reason to treat corporate credit unions and natural person credit unions differently, there is no obvious reason why any internal control and external audit requirements should be different.

4. *Should management's assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, (i.e., financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes), or should it be more narrowly framed to cover only certain types of financial reporting?*

   For consistency purposes, any attestation requirements imposed by NCUA should apply to all financial reporting including financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes. The credit union's internal auditor should be responsible for auditing other reports that are prescribed by the credit union's board policies and decision making authority.

5. *Should the same auditor be permitted to perform both the financial statement audit and the "attestation on internal controls" over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the "attestation on internal controls?"*

48

It should be up to the credit union to decide whether to have one entity perform both the financial statement audit and the attestation on internal controls. It would be costly for credit unions if they were required to have these services provided by separate sources. Adding the attestation alone will increase the costs associated with audits; requiring someone independent of the external auditor to perform the attestation is overly burdensome without benefit.

If an "attestation on internal controls" were required of credit unions, should it be required annually or less frequently?

Internal auditing within a credit union should be risk-based; this means internal audit should be tasked with creating a risk assessment for products and services offered by the credit union and then audit those affected areas as needed, based on risk. In this case, higher risk areas, such as investments, should be audited at least annually, while other areas could be reviewed less frequently. Although SEFCU opposes the attestation requirement, if it is required on internal controls, NCUA should apply the Sarbanes-Oxley timeframe for auditor rotation, which is 5 years. For consistency, this standard should be applied unless there is a significant event which requires an attestation sooner.

If an "attestation on internal controls" were required of credit unions, when should the requirement become effective (i.e., in the fiscal period beginning after December 15 of what year)?

If attestation on internal controls is required, it should not be mandatory for at least 18 months after the final rule becomes effective. Sarbanes-Oxley provided two years for public companies to comply with the new audit standards; SEFCU would support an effective date extended out anywhere from 18 months to three years. This would give credit unions ample time to digest the requirements, budget for the increased fees and costs associated with the added work by the external auditor and negotiate beneficial amendments to the engagement letter.

If credit unions were required to obtain an "attestation on internal controls," should Part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB's AS 2 standard that applies to public companies, or to the AICPA's revised AT 501 standard that applies to non-public companies?

If attestation on internal controls were required, credit unions should only be subject to the AICPA's AT 501 standard. Credit unions are not public companies and should not be subject to standards that are intended for public companies, such as the PCAOB's AS 2.

Should NCUA mandate COSO's Internal Control – Integrated Framework as the standard all credit union management must follow when establishing, maintaining

487

and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?

Although COSO is a widely recognized standard, NCUA should not mandate that credit unions utilize COSO's Internal Control – Integrated Framework, as COSO was created mainly for use by public companies. Credit unions should not be required to adhere to standards that were not written for them.

Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters?

Credit unions are founded on volunteerism. It's one of the qualities that make credit unions unique. The industry has fought many a battle on Capitol Hill in Washington and in state houses around the country to maintain our uniqueness from others in the financial services industry. The Supervisory Committee is, by statute, required to be comprised of members of the credit union. As such, the committee members should be representative of the members served by the credit union. The Supervisory Committee plays a key role in the continued safety and soundness of the credit union and it remains the neutral liaison between the board and the members. That being said, it is reasonable to expect committee members to have or obtain a certain amount of knowledge or expertise in their area. This should be left up to each individual credit union to determine and to mandate the training schedule and timetable. There is a great deal of educational material widely available to credit unions in this regard. The credit union's asset size is immaterial. The effectiveness of the Supervisory Committee should be reviewed and examined based on outcomes, not on the paper qualifications of the participants.

Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel?

Supervisory committees should only have access to their own outside legal counsel in the event there are allegations or an investigation of fraud perpetrated by the CEO or other executive(s), embezzlement or other misappropriation of credit union funds. Only under very limited circumstances would the Supervisory Committee act on its own behalf and not in concert with the board and executive management of the credit union. The credit union's asset size is not material to this issue.

Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor?

Use of the term "customer" in this question raises questions as to what exactly NCUA is getting at here. As with any fiduciary relationship, Supervisory Committee members have a duty to remain neutral, act in the best interest of the credit union and not have inappropriate relationships with any "customers" of the credit union. It is

assumed that NCUA intends the term customer to include members, borrowers, vendors and any other entity or individual who conducts business with the credit union. There are already several conflict of interest provisions in the FCU Act and NCUA's Rules and Regulations and any such relationship is subject to these provisions. Good business practice dictates that any volunteer official of a credit union would not exert, or subject him- or herself to, undue influence, and would recuse him- or herself from discussions and votes when proper. Additional regulation here is unnecessary.

13. *If any of the qualifications addressed in questions 10, 11 and 12 above were required of Supervisory Committee members, would credit unions have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers?*

Education mandates or other qualifications would very definitely make it more difficult for credit unions to recruit and retain volunteers. As stated previously, the FCU Act requires federal credit unions to have a Supervisory Committee comprised of members of the credit union. The issue of who is available, not to mention willing, to serve is limited to the credit union's field of membership. Credit unions should have the ability to mandate their own volunteer qualifications and make sure their volunteers have access to the necessary training to enable them to do their jobs.

14. *Should a State-licensed, compensated auditor who performs a financial statement audit and/or "internal control attestation" be required to meet just the AICPA's "independence" standards, or should they be required to also meet SEC's "independence" requirements and interpretations?*

State-licensed auditors performing credit union audits should only be required to meet the AICPA's "independence" standards. Any standards issued by the SEC are intended for public companies and are not appropriate for credit unions.

15. *Is there value in retaining the "balance sheet audit" in existing §715.7(a) as an audit option for credit unions with less than $500 million in assets?*

The majority of insurance fund losses occur in credit unions that are less than $500 million in assets. Since there are numerous external audit firms which focus on providing audit services almost exclusively to credit unions, the cost of a full financial statement audit is normally affordable to credit unions regardless of asset size. Therefore, SEFCU supports requiring full financial statement audits for credit unions regardless of asset size.

16. *Is there value in retaining the "Supervisory Committee Guide audit" in existing §715.7(c) as an audit option for credit unions with less than $500 million in assets?*

This may be applicable and/or beneficial only to relatively small credit unions. Any time additional requirements or more complex audits are required, the costs associated with such audits increase. We recommend that NCUA evaluate the

number of credit unions obtaining this type of audit to determine whether the option is being utilized and whether the audit data is beneficial to the credit union and NCUA.

17. *Should Part 715 require credit unions that obtain a financial statement audit and/or an "attestation on internal controls" (whether as required or voluntarily) to forward a copy of the auditor's report to NCUA?*

    NCUA has access to all the credit union's records, financial statements, attestations (if eventually required) and any other information it deems necessary to review. NCUA should plan to review these documents as part of a credit union's regularly scheduled examination. It is inefficient and redundant to provide information to NCUA throughout the course of the year.

18. *Should Part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union?*

    NCUA should plan to review these documents as part of a credit union's regularly scheduled examination.

19. *If credit unions were required to forward external auditors' reports to NCUA, should Part 715 require the auditor to review those reports with the Supervisory Committee before forwarding them to NCUA?*

    As oversight of the annual audit engagement is a primary responsibility of the Supervisory Committee, all reports and results should be discussed and reviewed with the committee in advance of forwarding the external auditor's reports to NCUA.

20. *Existing Part 715 requires a credit union's engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?*

    The current target date of 120 days is generally appropriate and sufficient. Sanctions, if any, should be on a case-by-case basis, as any delay may not be the sole responsibility, or within the control, of the credit union. Whether the violation was willful or not should also be a determining factor.

21. *Should Part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?*